

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2013-01 IT
June 26, 2013

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ISSUES

Income Tax – Business vs. Non-Business Income; Allocation vs. Apportionment

A company ("Taxpayer") is seeking an opinion as to:

- (1) Whether income that it derived from Taxpayer's restructuring constitutes "business income" or "nonbusiness income"; and
- (2) Based upon the classification of the aforementioned income, how said income should be allocated or apportioned in Indiana.

Authority: I.C. 6-3-1-20; I.C. 6-3-1-21; I.C. 6-3-2-2; I.C. 6-3-2-2.2; [45 IAC 3.1-1-29](#); [45 IAC 3.1-1-30](#).

STATEMENT OF FACTS

Taxpayer provides the following facts regarding its request for a revenue ruling. Taxpayer, which is incorporated in Ohio, but commercially domiciled in North Carolina, manufactures waste handling and recycling equipment for residential and commercial use. In particular, Taxpayer further provides:

Taxpayer develops products, systems, and solutions to collect, store, and transport various waste and recycling materials. Taxpayer also offers services such as custom waste and recycling removal and solutions and waste stream evaluations to maximize revenues from recyclables. Taxpayer has 24 manufacturing facilities across North America, including one in Indiana.

For its entire history, Taxpayer had been set up as a C Corporation. However, on June 14, 2012, Taxpayer voluntarily converted into an Ohio LLC. Taxpayer did not meet the solvency requirement of Internal Revenue Code Section 332 and, thus, the conversion was not eligible for tax-free treatment. For federal income tax purposes, the conversion to an LLC was considered a taxable sale of assets for their fair market value. Taxpayer recognized gain on the transaction equal to the difference between the proceeds and its basis in the assets sold. This gain recognized by Taxpayer was attributed to its sale of tangible property, identifiable intangible property, real property, and goodwill.

DISCUSSION

Taxpayer requests that the Department rule:

- (1) Whether income that Taxpayer derived from its restructuring constitutes "business income" or "nonbusiness income"; and
- (2) How Taxpayer's income at issue should be allocated or apportioned in Indiana based upon the classification of the aforementioned income.

Issue #1 – Business Income vs. Nonbusiness Income

I.C. 6-3-1-20 defines the term "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations." Accordingly, the term "nonbusiness income" means "all income other than business income." I.C. 6-3-1-21.

At this juncture, it is important to note that the definition of "nonbusiness income" is defined by explicit reference to that which is not "business income." More to the point, in this particular instance, whether or not the income of Taxpayer is nonbusiness income is a question that can only be answered after determining exactly what constitutes its business income. After the determination of the scope of a taxpayer's business income is made, only then can we consider whether or not the income at issue falls outside of said scope. In defining nonbusiness income in such a way, the legislature seems to implicitly require that a taxpayer demonstrate exactly why the income at issue constitutes nonbusiness income outside the bounds of what constitutes its business income.

[45 IAC 3.1-1-29](#) provides in pertinent part:

The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, non-operating income, etc., is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business.

[45 IAC 3.1-1-30](#) provides:

For purposes of determining whether income is derived from an activity which is in the regular course of the taxpayer's trade or business, the expression "trade or business" is not limited to the taxpayer's corporate charter purpose of its principle business activity. A taxpayer may be in more than one trade or business and derive business therefrom depending upon but not limited to some or all of the following:

- (1) The nature of taxpayer's trade or business.
- (2) The substantiality of the income derived from activities and transactions and the percentage that income is of the taxpayer's total income for a given tax period.
- (3) The frequency, number, or continuity of the activities and transactions involved.
- (4) The length of time the property producing income was owned by the taxpayer.
- (5) The taxpayer's purpose in acquiring and holding the property producing income.

As applied to Taxpayer's circumstances as it has described them and as we understand them, we believe that we were not given sufficient information to allow us to determine that this income falls outside the scope of what constitutes its business income. Taxpayer has described its business activities, as well as the transaction in question, in extremely broad and generalized terms. Specifically, the vague and broad descriptions offered are of no help in analyzing the transaction and income derived from it through the lens of the factors listed in [45 IAC 3.1-1-30](#). Based upon the information offered by Taxpayer, the Department has no information with regards to aspects of the transaction like the substantiality of the income derived from activities and transactions, the percentage the income in question represents relative to Taxpayer's total income for a given tax period, the length of time that Taxpayer owned the property producing the income, or the taxpayer's purpose in acquiring and holding said property. The statutory language and interplay between the two above referenced definitions of income seem to implicitly require a taxpayer to demonstrate why specific income is not within the scope of its business income. Accordingly, because Taxpayer has not provided us with sufficient information to allow us to determine that the income at issue here is nonbusiness income, the Department will treat it as business income until such a time that Taxpayer offers an adequate showing as to why this income is to be treated as nonbusiness.

Issue #2 – Apportionment

Having determined that the income herein at issue will be considered business income until such a time that it is shown by the Taxpayer to be nonbusiness income, all that is left is to determine how to apportion this income. As stated above, all of the property that generated this income has been represented by the Taxpayer to fall within one of the following three categories: (a) Real Property, (b) Tangible Property, and (c) Identifiable Intangible Property.

With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana" shall mean and include, in pertinent part, income from real or tangible personal property located in this state, as well as income from other intangible personal property to the extent that the income is apportioned to Indiana under this section. [IC 6-3-2-2\(a\)](#). "[I]f business income of a corporation or nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana by... (5) [f]or all taxable years beginning after December 31, 2010, the sales factor." [IC 6-3-2-2\(b\)](#). The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. (Emphasis added.) [IC 6-3-2-2\(e\)](#).

With regard to the category of "Tangible Property" generating Taxpayer's income herein at issue, "sales of tangible personal property are in this state if (1) the property is delivered or shipped to a purchaser that is within

Indiana, other than the United States government; or (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and (A) the purchaser is the United States government, or (B) the taxpayer is not taxable in the state of purchase." [IC 6-3-2-2\(e\)](#). Thus, to the extent that the sales of tangible personal property were "in this state" pursuant to the above quoted statutory language, those sales are apportioned to Indiana and shall be included in Taxpayer's calculation of the numerator of the sales factor.

Regarding the category of "Real Property" generating Taxpayer's receipts herein at issue, receipts derived from the sale of real property is in the state to the extent that the real property itself is located within the state. Therefore, to the extent that Taxpayer generated receipts from the sale of real property located within Indiana, those receipts are to be apportioned to Indiana and shall be included in the Taxpayer's calculation of the numerator of the sales factor.

As for the category of "Identifiable Intangible Property" generating Taxpayer's income herein at issue, "[r]eceipts from intangible personal property are derived from sources within Indiana if the receipts from the intangible personal property are attributable to Indiana Under [\[IC 6-3-2-2.2\]](#)." [IC 6-3-2-2\(e\)](#). Alternatively, sales of intangibles not covered by [IC 6-3-2-2.2](#) are in this state if either (1) the income-producing activity is performed in this state, or (2) the income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance. [IC 6-3-2-2\(f\)](#). Unfortunately, the Taxpayer in this instance has not provided the Department with enough information to determine whether the sales of the vaguely described "Identifiable Intangible Property" should be analyzed under [IC 6-3-2-2\(f\)](#) or [IC 6-3-2-2.2](#) to determine whether those sales were in Indiana. Therefore, to the extent that the Taxpayer has sales of intangibles that are within Indiana based upon application of [IC 6-3-2-2\(f\)](#) or [IC 6-3-2-2.2](#), those sales are to be apportioned to Indiana and shall be included in the Taxpayer's calculation of the sales factor.

RULING

Taxpayer has failed to offer sufficient support to justify its treatment of the income from its corporate restructuring as "nonbusiness income." Therefore, until such a time that Taxpayer provides the Department with an adequate showing as to why this income should be considered "nonbusiness income," we shall treat it as "business income." Accordingly, the income shall be apportioned to Indiana consistent with the above statements relating to each category of property generating income or receipts for Taxpayer.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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